AIA Views on Contract Finance and Opportunities to Incentivize ‘Performance’

DARS/DPC, OUSD(A&S) Public Meeting on
“Contract Finance” (DFARS Case 2019-D001)
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Overview

- Key Considerations for Contract Finance Policy
- AIA Concerns Regarding an 'Enterprise-wide' Approach For Incentivizing Performance
- Industry Proposals to Incentivize 'Performance'
  - Encourage On-Time Deliveries through Increased Use of PBPs
  - Ensure Timely Quality Proposals by Streamlining the Proposal Submission and Negotiation Process
  - Revisit Recommended Incentives for, and Feasibility of, the Superior Supplier Incentive Program (SSIP)

Key Considerations for Contract Finance Policy

- Contract finance and profit policies are interrelated
- Changes to contract finance rates will impact the health, competitiveness and resiliency of defense industrial base and supply chain
- Budget disruptions, CRs, delays/length of contracting process, and other factors force contractors to fund programs ‘at risk’
- Requirement for Progress Payment System and Job Order Accounting System impact financing levels and serve as a barrier to entry for small and medium sized businesses and commercial companies of all sizes
- Contract finance terms must be aligned with investment (i.e. R&D, workforce, CapEx, cyber) expectations for industry to support execution of the *National Defense Strategy*

Key Considerations for Contract Finance Policy (con't)

- Availability/use of alternative liquidation rate to alleviate working capital requirements, particularly on long duration programs
- Frequency of billings
- Statutory 'ceilings' (i.e. limitation of contract financing to progress payments at 80% of incurred costs under letter contracts) and 'floors' for certain types of contracts (i.e., MRO for Naval vessels), and products/services that do not utilize progress payments conditioned on incurred cost (i.e. shipbuilding, construction)
- Interest rate trends and outliers
- Prevalence, length, and value of Undefinitized Contract Actions (UCA)
- Prevalence/value/risk/length/finance terms of various contracts (i.e. Cost-type, FPIF, Fixed-price) and types (i.e., EMD, LRIP, Production)

AIA Concerns Regarding an ‘Enterprise-wide’ Approach To Incentivize Performance

- Data/systems to measure ‘enterprise-wide’ performance are unreliable and/or untested
- DoD already has foundational authorities to ensure performance on major programs – installing an enterprise-based construct will:
  - Escalate contract and program management functions that should be executed by COs/PMs
  - Elevate responsibilities/accountability delegated to Services back to OSD
- DoD has acknowledged there are not widespread performance problems within industry – enterprise-based approaches could hurt successful programs.
  - Instead, DoD should leverage established tools and implement existing statutory provisions to incentivize contractor performance where room for improvement exists

DoD has Foundational Authorities to Ensure Programs are High-Performing

- FY16 NDAA Sec 802: Reinforces that Services are customer of defense acquisition system – Service Chiefs responsible/accountable for balancing resources/priorities and associated tradeoffs among cost, schedule, performance, technical feasibility, and performance on MDAPs – this is meant to "ensure that acquisition systems are acquired and managed efficiently and effectively"
- FY16 NDAA Sec 821-825: Acquisition strategy/risk management/MS A&B requirements governed by USD(A&S) for MDAP/MAIS/major systems
- FY16 NDAA Sec 826-827: Tenure, responsibility, and accountability for Program Managers
- FY17 NDAA Sec 805 & 807 – 808: MOSA requirement, program cost/fielding/performance goals for MDAPs, independent technical risk assessments (ITRAs), and transparency for MDAP programs governed by Office of the Secretary of Defense

Existing Contract Management and Administration Tools Can Incentivize Performance

- On-Time Delivery/Delivery of Data Requirements:
  - FAR 52.232-16 and FAR 52.232-32 allow contracting officers to reduce or suspend payments, liquidate payments by deduction from any payment under the contract, or both due to unsatisfactory performance on progress payments and PBPs, respectively
  - Under DFARS 252.227-7030, contracting officers may withhold up to 10% of contract price if technical data is not delivered on time or is deficient upon delivery
- Small Business Subcontracting Goals:
  - Under FAR 52.219-16, a contracting officer can require a contractor to pay liquidated damages if he/she determines that the contractor failed to make a good faith effort to comply with their subcontracting plan
- Timely Quality Proposals
  - Under FAR 52.215-10, if a contractor submits defective certified cost or pricing data that results in overpayment, the contractor must pay interest compounded daily on overpayment, plus a penalty equal to the overpayment if contractor knowingly submitted inaccurate, incomplete, or noncurrent data

Existing Contract Management and Administration Tools Can Incentivize Performance

- Contractor Quality:
  - Level III Corrective Action Requests (CAR) "may result in initiation of available contractual remedies, such as reductions of payments, cost disallowances, revocation of government assumption of risk of loss, or business management systems disapprovals, etc."
  - Level IV CARs "result in a mandatory review of available contractual remedies, such as cost disallowance, reduction or suspension of payments, revocation of government assumption of risk of loss, business system disapproval, or suspension of product acceptance activities"
- Contactor Business Systems:
  - DFARS 252.242-7005 allows contracting officers to withhold 5% of payments for one or more significant deficiencies in a contractor business system or 10% for significant deficiencies in multiple contractor business systems

AIA Concerns Regarding an ‘Enterprise-wide’ Approach To Incentivize Performance

- ‘Enterprise-wide’ measures would constitute double, or triple jeopardy in some cases, without providing contractors an opportunity to be recognized and receive benefits for exceeding performance expectations
- If DoD decides to pursue an ‘enterprise-wide’ approach, it will need to pursue corresponding changes to the aforementioned (and other affected) FAR/DFARS provisions and related policies

Industry Proposals to Incentivize 'Performance'

Encourage On-Time Deliveries through Increased Use of PBPs

- DoD has previously recognized that PBPs provide the following benefits:
  - Enhanced Schedule and Technical Focus
  - Broadened Contractor Participation
  - Reduced Cost of Administration and Streamlined Oversight
  - Enhanced and Reinforced Roles of Program Managers and IPTs
- For contractors, PBPs enable improved cash flow, but at increased risk, providing incentive for on-time delivery
- These can be accomplished without a new DFARS rulemaking if DFARS Case 2019 – D002, “Preference for Performance-Based Payments,” is implemented consistent with the **intent** of law

Encourage On-Time Deliveries through Increased Use of PBPs (con't)

- If DFARS Case 2019-D002 requires contractors to provide consideration to use PBPs and/or a two-step negotiation process it will be inconsistent with intent of Section 831 of the FY17 NDAA
  - Requirement for consideration would contradict preference for PBPs at 10 USC 2307 – it is not a 'preference' if you must pay for it
  - Existing PBP Analysis Tool eliminates "win – win" potential of PBPs and is flawed for purposes of evaluating appropriate level of financing on contracts
- DFARS-unique clauses that link PBPs to incurred cost must be removed to satisfy 10 USC 2307(b)(2) and 2307(b)(4)(A)
- **Recommendations:**
  - PBP Analysis Tool should not be used – PBPs should be structured as they were pre-*Better Buying Power* to ensure both DoD, industry and taxpayers recognize benefits from PBPs
  - DoD should remove DFARS Clauses at 252.232-7012 and 252.232-7013, and align with FAR policy that allows for PBPs up to 90% of price

Ensure Timely Quality Proposals by Streamlining the Proposal Submission and Negotiation Process

- AIA made the following recommendations in January 2018 that can help support the timely submission of quality proposals and speed the contracting process:
  - Reduce time associated with certified cost and pricing data ‘sweeps’ by using ‘cutoff dates’ as encouraged at FAR 15.406-2
  - Employ a risk-based, materiality-driven approach to auditing, with increased reliance on approved contractor business systems in determining scope of analysis/audit requirements
  - Remove barriers to Long Term Agreements (LTAs)
  - Substantially reduce elapsed time from proposal submission to receipt of government first offer
  - Expand option and multi-year pricing and use recently-negotiated lot procurements as a basis for pricing subsequent lots
  - Reduce number of RFPs and associated reviews
  - Increase authority and discretion of contracting officers
  - Collaboratively set procurement milestones on sole source acquisitions
- **Recommendation:** Follow-on engagement between AIA & DPC/DCMA/DCAA to advance these recommendations

Revisit Recommended Incentives for and Feasibility of the SSIP

- In 2013, industry provided several ideas in response to a Department of the Navy request for public comments on their Superior Supplier Incentive Program (SSIP) pilot; for example:
  - Reduction or elimination of fee withholds
  - Authorize progress payment and interim cost billings on a more frequent basis
  - **<u>See backup for full list of recommendations</u>**
- Industry noted the challenges of aggregating performance data and the competitive, legal and regulatory barriers to offering incentives
- We encourage DoD to revisit performance measures and incentives contemplated by SSIP and address legal barriers that limited the incentives offered by SSIP if an ‘enterprise-wide’ performance construct is pursued


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Industry Recommendations to Superior Supplier Incentive Program

- Examples of general solicitation provisions, contract clauses, and performance incentives that would provide greatest motivation to be superior supplier:
  - Award Term Incentive (extend contract period of performance without additional competition)
  - FAR Part 12 commercial item contracts that incentivize the supplier to reduce costs by inserting the most current technologies that also enhance product performance and reliability
  - Cost Reimbursement Incentive Contracts (FAR 16.405)
  - Cost, Schedule, or Technical Performance Incentives (i.e., contractor rewards for cost underrun, additional fee/profit for improved delivery schedule, or rewards for improving performance of a product or service

Industry Recommendations to Superior Supplier Incentive Program (con't)

- Examples of contract terms and conditions that could be provided or removed for superior suppliers:
  - Authorize progress payment and interim cost billings on a more frequent basis than normal practice (FAR Clauses 52.232-16 and 52.216-7)
  - Eliminate or reduce fee withholding requirements on cost-type programs (FAR Clauses 52.216-8, 52.216-10, and 52.232-7)
  - Provide unusual progress payments up to 99% of incurred cost on contract that would not otherwise qualify for unusual financing under the requirements established by FAR 32.501-2 (Unusual Progress Payments)
  - Add greater return for superior suppliers that maintain consecutive quarters of 3- and/or 4-star ratings over the period of contract performance or another defined performance interval

Industry Recommendations to Superior Supplier Incentive Program (con't)

- Examples of contract terms and conditions that could be provided or removed for superior suppliers (con't):
  - Work with superior suppliers to ensure equitable commercial item determinations are made, including the use of FAR Part 12 contracts to motivate supplier performance
  - Provide relief from both source and destination inspections and from other government oversight actions, including audits, which will provide cost savings for both parties
  - Consider the potential for follow-on work that provides sustained superior performance; this will reduce cost to the government with little risk
  - Look into more frequent use of award term contracts as an entitlement mechanism to reward superior performance. For example, guaranteeing the top suppliers are afforded automatic inclusion in competitive procurements within their identified product or service areas creates the potential for the supplier to improve its new business capture
  - Provide acknowledgement and benefit in the source selection evaluation of supplier rating; it should cost the government less to manage a top supplier and the top suppliers' costs will be lower due to reduced government oversight